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SOVEREIGN DEBT SYMPOSIUM

Not only good faith

Staying of enforcement

MAURO MEGLIANI — 3 February, 2017

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Staying of enforcement plays a topical role in sovereign debt litigation as enforcing a debt claim may have a negative impact on the dynamics of restructuring processes and the regular functioning of financial markets for sovereign debt. Moreover, in the case of Highly Indebted Poor Countries (HIPCs), it may also affect the resources pledged for social expenditure. As a response to this problem, in January 2012 the United Nations Conference on Trade and Development (UNCTAD) adopted the Principles on Promoting Responsible Sovereign Lending and Borrowing which serve the purpose of providing a common level playing field for any type of sovereign indebtedness in negotiating and restructuring the terms of loan agreements. According to Principle No. 7, lenders are called to behave in good faith and with cooperative spirit with debtors towards a consensual rearrangement of the outstanding debt. As a corollary, good faith would involve a standstill in enforcing sovereign debt claims in connection with sovereign workouts. A number of decisions delivered by certain municipal courts would point to the progressive emergence of this rule (Goldmann, pp. 136-140).

However, this picture presents some flaws. First of all, the case-law is not so conclusive to deduce the emergence of a precedent. Moreover, the stay of enforcement is connected to specific circumstances: it is related to a restructuring process and confined to a limited period of time. This implies that outside this scheme the stay of enforcement could not operate. Nevertheless, the need to stay enforcement of debt claims against a sovereign borrower in distress can arise also under different situations. To the extent that enforcing may negatively affect the provision of social services it is possible to resort to an alternative route by considering stay of enforcement as a corollary of debt sustainability.

Staying – but not too long

At first sight, the analysis of certain US cases would indicate the emergence of a trend towards staying of enforcement. However, the conditions set out in this cases for staying are so circumscribed as to appear more exceptional and limited occurrences rather than an emerging precedent. They are not really able to erode the doctrine of the bindingness of contracts (pacta sunt servanda). Therefore, the fundamental rule that creditors' rights are fully enforceable against a restructuring process and its implementation is substantively preserved.

In Pravin Banker IV, the Court of Appeals emphasised that an indefinite suspension of the proceedings pending the outcome of a restructuring process would contradict the prevailing principle that creditors' rights should be safeguarded and make the enforcement of their rights conditional on the completion of a process without a deadline. Consistent with this view, the Court upheld a 6-month suspension granted by the lower court (Pravin Banker Associates Ltd. v. Banco Popular del Peru, 109 F 3d 850 (2nd Cir 1997)).

Also in EM Ltd the Court of Appeals for the Second Circuit held that the lower court was right in using its discretion on vacating the attachment so as to avoid a substantial risk to the outcome of an ongoing restructuring process, which was "of critical importance to the economic health of a nation" (EM LTD et al. v. The Republic of Argentina, 131 Fed Appx 745 (2nd Cir 2005)). This position was supported by the Department of Justice that in its Statement of Interests underscored the need for a consensual orderly restructuring process under the auspices of the international financial institutions.

The position by the Department of Justice played a key role also in Allied Bank, though with a different outcome. The Court of Appeals for the Second Circuit stayed the enforcement of creditors' claims on the comity assumption that the Costa Rica's prohibition of payments was not a repudiation of the debt but rather a mere deferral of payments pending negotiations (Allied Bank Int'l v Banco Credito Agricola de Cartago 733 F2d 23 (2d Cir 1984)). However, on rehearing the Court reversed its previous decision acknowledging the contrariety expressed by the US Administration and thereby enforced the claims (Allied Bank int'l v. Banco Credito Agricola de Cartago, 757 F2d 516 (2d Cir 1984)).

In Capital Ventures the Court of Appeals for the Second Circuit confirmed the attachment to the collateral of the Brady Bonds involved in the exchange offer arranged by Argentina in 2010, by emphasising that the remedy was just a consequence of the exercise of Capital Ventures' contractual rights under New York law. Further, the small amount of the bonds involved in the 2010 exchange offer did not imply that a failure of the offer would have had a negative effect for Argentina (Capital Ventures Int'l v. Argentina, 652 F.3d 266 (2011)).

Along the same lines, in NML the Court of Appeals for the Second Circuit underscored that it is consistent with the necessity to preserve the integrity of the rule pacta sunt servanda to require debtors, including foreign sovereign debtors, to pay their dues. Moreover, the Court rejected the argument that the judicial victory by creditors would have encouraged more bondholders to step out of the restructuring processes to secure better terms and emphasised that the Argentina was a "uniquely recalcitrant debtor" (NML Capital Ltd v. Republic of Argentina, 727 F.3d 230 (2nd Cir)).

Against that background, the only room for manoeuvre for a medium-term stay of enforcement in relation to disruptive claims brought against a sovereign debtor is a clear statement by the US Administration on its consistency with the law and policy of the United States. Unfortunately, it is rather unlikely that the incoming US Administration would take such a step.

Stay the unsustainable

In the absence of a comity endorsement by the US Administration, the justification for staying must be found elsewhere. A workable solution consists of raising the defence of debt sustainability. From an international law point of view, debt sustainability might amount to a general principle of international law reflecting two public interests: economic development and protection of human rights (Bohoslavsky and Goldmann, p. 21, 26). In this context, debt sustainability does not necessarily coincide with IMF Debt Sustainability Analysis as this latter does not take into sufficient account social standards and distributional consequences of restructurings and adjustments (Riegner, p. 148). This is particularly evident when enforcing a sovereign debt would impair the provision of social services to the population. In a case like that, payments would be suspended and tailored accordingly.

In the case of enforcing foreign judgments, this rule may come into play within the umbrella of international public policy. Compared to internal public policy, international public policy is certainly narrower in operation but wider in content as it also includes norms of international law. These norms would also reasonably comprise the necessity to preserve a minimum standard of social rights by means of rescheduling payments.

In the case of enforcing contractual rights, this rule may come into play as a sort of overriding mandatory rule of the forum to be applied irrespective of the applicable law. If we assume that these mandatory rules consist of provisions the respect of which is regarded as crucial for safeguarding public interests of a specific country, such as its political, social, or economic organisation (cf. Art. 9, para 1, Regulation (EC) 593/2008), it is not unreasonable to hold that the necessity to preserve a certain level of social services may fall within this purview with the consequential corollary of a rescheduling of payments.

Although debt sustainability is better appreciated under a restructuring process, it can also play a role in courts as far as single enforcements would negatively affect the provision of social services. This the case of HIPCs the resources of which can easily be negatively affected by enforcements. As recorded in the practice, the potential impact of judicial awards for these countries have varied from less than 0.5 per cent to 49 per cent of the debtor country's gross domestic product (GDP) (Cephas Lumina, Report of the independent expert on the effects of foreign debt, 2010, pp. 5-6). A legal defence like that described above may certainly reduce the problems associated with enforcement in these cases.

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